

RETIREE

IMPORTANT TAX IMPLICATIONS FOR ENROLLING SAME-SEX PARTNERS

The State pays the cost of covering a same-sex partner and eligible dependent children under the retiree medical plan. You pay the full premium for optional coverage under the Dental/Vision/Audio plan and the Long-term Care plan if you elected these benefits. Because of this, there are financial and tax implications to consider. The Internal Revenue Service (IRS) has determined that the cost of providing benefits for same-sex partners and their children who do not meet the IRC Section 152 (as modified by IRC Code Section 105(b)) definition of qualified “dependents” is considered ordinary or “imputed income” and is, therefore, subject to taxes.

If a same-sex partner or same-sex partner’s child is not a “dependent” of the member under federal tax law, the State must report the fair market value (FMV) of a member’s same-sex partner/child benefits as wages or “imputed income” to the Internal Revenue Service, resulting in increased taxable gross income for federal income taxes as well as Medicare taxes withheld from the retiree’s check. In that case, the cost to the member of obtaining benefits for a same-sex partner and/or child of a same-sex partner is actually more than just the cost of the State paid premium.

Imputed income attributable to you for your same-sex partner’s and/or your same-sex partner’s eligible children’s coverage will be reported on your retiree warrant for tax purposes. This amount represents the cost of providing benefits for your same-sex partner and/or their eligible children so that required taxes on the imputed income will be deducted from your retirement check.

Because the child of a same-sex partner must be financially dependent on you to be eligible for coverage under the retiree medical plan, in most situations a child of a same-sex partner who is eligible for coverage under the medical plan will also be a dependent of the retiree under federal tax law, and no income will be imputed to you for coverage of the child for federal tax purposes. If, however, the child is eligible for coverage but does not qualify as a dependent under federal tax law, imputed income would be attributable to you for that child’s coverage.

Imputed income does not affect calculations for member-elected and paid benefits, such as dental/vision/audio or long-term care. Nor does imputed income affect dependent life coverage because benefits are paid entirely by the member and deductions are always taken on an after-tax basis.

The following table shows the amount of income that will be imputed each month based on benefit plan elections made during this special enrollment for 2007. In most cases Medicare taxes equal to 1.5% of the imputed amounts shown and federal income tax will be withheld. The actual amount of income tax withheld depends on your retirement pay and the amount of allowances you claim on Form W-4. Imputed income amounts are included for coverage of children of a same-sex partner, in the unusual event that the covered child is not a “dependent” for federal tax purposes.

Fair Market Value for Non-Tax Qualifying Dependents (These numbers do NOT represent the tax you will pay)

| Coverage Level | Calendar Year 2007 Monthly Imputed Income |
|---|--|
| Retiree Only | N/A |
| Retiree and Same-sex Partner | \$590 |
| Retiree and Child of Same-sex Partner | \$243 |
| Retiree and Family (Including same-sex partner and child of same-sex partner) | \$833 |

An Exception to the Rule: *Dependents for Federal Income Tax Purposes*

If your same-sex partner and same-sex partner's eligible dependent children qualify as your dependents under IRC Section 152 (as modified by IRC Section 105(b)), the costs for their benefits are not considered taxable income to you. Generally, to qualify as an IRC Section 152 dependent (as modified by Code 105(b)) of a retiree during a given tax year, the same-sex partner (and, if eligible under the Plan's rules, the same-sex partner's children) must be a "qualifying relative" of the retiree. To be a "qualifying relative," the same-sex partner and/or child of the same-sex partner must meet the following requirements:

1. Have the same principal place of abode as the retiree for the full tax year (January 1 through December 31), except for temporary absences such as vacation, military service, or education. If the partnership dissolves other than on December 31, for reasons other than the death of the same-sex partner, the tax exclusion is lost for the entire year. If the relationship terminates due to the death of the partner, the partner would continue to be treated as a dependent for the entire tax year;
2. Receive more than half of his or her support from you, the retiree;
3. Be a U.S. citizen, U.S. national, or a resident of U.S., Canada, or Mexico; and,
4. Not be anyone else's "qualifying child" under IRC Section 152.

Whether or not you will be claiming your same-sex partner and partner's dependent children as tax dependents for insurance purposes under IRC Section 152 (as modified by IRC Section 105(b)) you must complete and sign the Declaration of Tax Status Form (PDF). It may be required that Section 152 dependent status be redeclared each tax year.

Retirees are strongly encouraged to consult with a tax advisor before declaring a same-sex partner satisfies each of the above requirements to be considered a qualifying relative as defined by the IRS. The State will assume your same-sex partner DOES NOT qualify as your tax dependent for tax-free health insurance if you do not file a declaration that the same-sex partner meets the requirements to be considered a qualifying relative.

Please note:

This information is not intended as tax advice but rather to alert retirees of potential tax ramifications and IRS rules.

The State recommends all retirees wishing to enroll their same-sex partner under a State-sponsored plan consult with a qualified tax advisor to fully understand the tax issues involved.